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# Health Reimbursement Arrangement (HRA)

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## HEALTH REIMBURSEMENT ARRANGEMENTS (HRA)

— by Neil E. Harl\*

So-called Section 105 Plans<sup>1</sup> have been used rather widely to provide deductible medical insurance coverage for employees or to furnish a medical reimbursement plan for employees.<sup>2</sup> If successful, costs are deductible and benefits are excludible from income.<sup>3</sup>

In late June, the Internal Revenue Service announced the creation of a new concept, the Health Reimbursement Program (HRA), with features not available in traditional Section 105 plans.<sup>4</sup>

### Features of an HRA

Several conditions are imposed for the new form of medical reimbursement plan, the Health Reimbursement Arrangement,<sup>5</sup> to be available

- Payments must be made solely by the employer (and not made under a salary reduction election or a cafeteria plan<sup>6</sup> although HRAs can be integrated with a cafeteria plan as noted below).<sup>7</sup>

- The HRA reimburses the employee for medical care expenses incurred by the employee and the employee's spouse and dependents;<sup>8</sup> and

- The HRA provides reimbursements up to a maximum dollar amount for a coverage period *and any unused portion of the maximum dollar amount at the end of the coverage period is carried forward to increase the maximum reimbursement amount in subsequent coverage periods.*<sup>9</sup> This is the critical difference between a medical reimbursement plan and a Health Reimbursement Arrangement.

### Qualification requirements

In order to qualify for an exclusion of benefits from income, an HRA may only provide benefits that reimburse expenses for medical care as defined in I.R.C. § 213(d).<sup>10</sup> It is noted that reimbursements for insurance covering medical care expenses are allowable reimbursements under an HRA.<sup>11</sup>

An HRA may neither reimburse a medical care expense that is incurred before the date the HRA is in existence<sup>12</sup> nor reimburse a medical care expense incurred before the date an employee is first enrolled under an HRA.<sup>13</sup> Further, an HRA may not reimburse a medical care expenses attributable to a medical deduction for any prior taxable year.<sup>14</sup>

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An HRA does not qualify for the exclusion<sup>15</sup> if any person has the right to receive cash or any other taxable or non-taxable benefit other than the reimbursement of medical care expenses.<sup>16</sup> Indeed, if any person has such a right under an HRA currently or for any future year, all distributions to all persons made from the arrangement in the current year are included in gross income, even amounts paid to reimburse medical care expenses.<sup>17</sup> An example in *Notice 2002-45*<sup>18</sup> states that if an arrangement pays a death benefit without regard to medical care expenses, no amount paid under the HRA to any person is a reimbursement for excluded medical expenses.<sup>19</sup>

Medical care expense reimbursements under an HRA are excludible to the extent reimbursements are provided to

- Current and former employees (including retired employees), their spouses and dependents, and
- Spouses and dependents of deceased employees.<sup>20</sup>

As noted above, employer contributions to an HRA may not be attributable to salary reduction or otherwise provided under a cafeteria plan.<sup>21</sup> However, an HRA is not considered to be paid pursuant to salary reduction merely because it is provided in conjunction with a cafeteria plan.<sup>22</sup> An HRA may be integrated into a cafeteria plan.<sup>23</sup> But an arrangement is not treated as an HRA if the arrangement interacts with a cafeteria plan in such a way as to result in salary reduction indirectly to fund the HRA.

#### Non-discrimination rules

The statute<sup>24</sup> contains non-discrimination rules for self-insured medical expense reimbursement plans. To the extent an HRA is a self-insured medical expense reimbursement plan, the non-discrimination rules apply to an HRA.<sup>25</sup> For insured plans, there is no non-discrimination requirement.<sup>26</sup>

#### Applicability to self-employed individuals

An HRA may not be set up to provide benefits directly to a self-employed individual.<sup>27</sup> There is no bar to providing benefits to a self-employed individual as the dependent of an eligible employee.

#### In conclusion

Although neither *Notice 2002-45*<sup>28</sup> nor *Rev. Rul. 2002-45*<sup>29</sup> prescribes the formalities required to set up an HRA, it seems prudent to support such a plan with a document in writing which defines the terms of the annual reimbursement by the employer, the coverage period for the medical expense reimbursement and the eligibility requirements for employees to participate in the HRA.

#### FOOTNOTES

<sup>1</sup> I.R.C. § 105. See 7 Harl, *Agricultural Law* § 57.02[1] (2002); 4 Harl *Agricultural Law* § 28.02[6][d] (2002); Harl, *Agricultural Law Manual* § 7.02[4][b][i] (2002). See also Harl, "More Guidance on Section 105 Plans," 10 *Agric. L. Dig.* 65 (1999); Harl, "Effective Date of 'Section 105' Plans," 6 *Agric. L. Dig.* 121 (1995).

<sup>2</sup> See Coord. Issue Paper, IRPO ¶80,400, March 29, 1999; Coord. Issue Paper, IRPO ¶180,068, Jan. 25, 2001. See also

Ltr. Rul. 9409006, Nov. 12, 1993 (bona fide employer-employee relationship conceded in husband-wife arrangement; costs were deductible by employer and amounts not taxable to employee).

<sup>3</sup> I.R.C. § 105. See *Epstein v. Comm'r*, T.C. Memo. 1992-53; Rev. Rul. 71-588, 1971-2 C.B. 91.

<sup>4</sup> Rev. Rul. 2002-41, I.R.B. 2002-28; Notice 2002-45, I.R.B. 2002-28.

<sup>5</sup> *Id.*

<sup>6</sup> I.R.C. § 125.

<sup>7</sup> Notice 2002-45, I.R.B. 2002-28.

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> Notice 2002-45, I.R.B. 2002-28.

<sup>11</sup> *Id.*

<sup>12</sup> See Harl, "More Guidance on Section 105 Plans," 10 *Agric. L. Dig.* 65 (1999) for a discussion of retroactivity for medical reimbursement plans.

<sup>13</sup> Notice 2002-45, I.R.B. 2002-28.

<sup>14</sup> *Id.*

<sup>15</sup> I.R.C. § 105(b).

<sup>16</sup> Notice 2002-45, I.R.B. 2002-28.

<sup>17</sup> *Id.*

<sup>18</sup> I.R.B. 2002-28.

<sup>19</sup> *Id.*

<sup>20</sup> Notice 2002-45, I.R.B. 2002-28.

<sup>21</sup> See note 5 *supra* and accompanying text.

<sup>22</sup> Notice 2002-45, I.R.B. 2002-28.

<sup>23</sup> See Rev. Rul. 2002-41, I.R.B. 2002-28.

<sup>24</sup> I.R.C. § 105(h).

<sup>25</sup> Notice 2002-45, I.R.B. 2002-28.

<sup>26</sup> See I.R.C. § 105(h).

<sup>27</sup> Notice 2002-45, I.R.B. 2002-28. See I.R.C. § 105(g).

<sup>28</sup> I.R.B. 2002-28.

<sup>29</sup> *Id.*

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